

# Regional trade agreements in sub-Saharan Africa: supporting export diversification

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## Introduction

The last decade was one of relative export success for sub-Saharan Africa (SSA) as a whole, punctuated by the global crisis of 2009. However, much of this growth has been driven by rising global demand for primary commodities. The key development challenge for SSA, therefore, remains export diversification to provide for a broader base for sustained export growth, less vulnerability to volatile world prices and to spread the benefits of trade more widely.

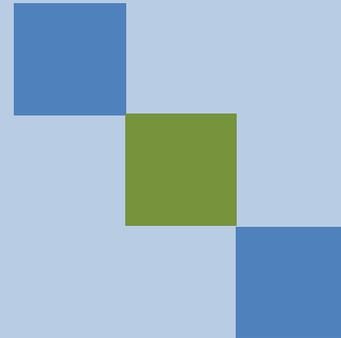
This note briefly discusses the recent export performance in SSA and the impact of the global crisis on trade. It proceeds to argue that regional integration in SSA can play a critical role in allowing countries to exploit opportunities for export diversification both

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## Africa Trade Policy Notes

### Note #15



in regional and global markets. The note discusses recent progress in a number of regional trade agreements (RTAs) in SSA, especially with regard to reducing tariffs on regional trade, but argues that considerable potential for intra-regional trade in both goods and services remains unexploited due to the persistence of policy-related barriers. Two key areas require attention: disciplining and removing non-tariff barriers (NTBs) and achieving more integrated services markets. In both cases the policy agenda revolves around regulations, their impact on trade and appropriate rules for integrated markets. Support for governments that wish to reform regulations can be provided through the establishment of knowledge platforms. These would make available information on barriers to trade and their economic costs; regulatory reform options and experiences elsewhere in implementing reform so as to ensure that regulations and their implementation are carefully tailored to the demand and supply conditions in SSA; and, implications for different stakeholders to enable policy makers to address political

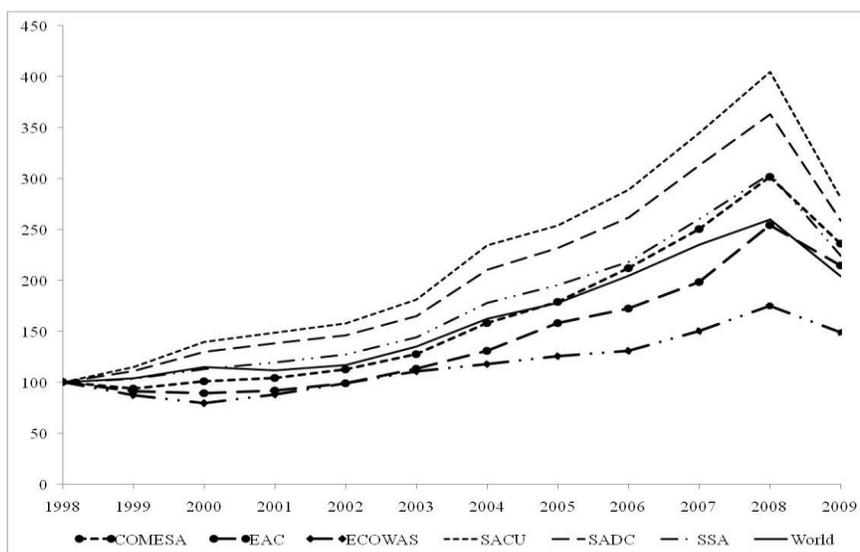
economy constraints that may undermine these reform efforts.

**Until the onset of the financial crisis, the region was growing and transforming**

Between 2000 and 2008, SSA countries grew rapidly and often at much higher rates than the world average, infusing the region with a new commercial vibrancy. Growth was fueled, in part, by the commodity boom especially for exports of minerals to new fast-growing markets such as India and China (see Figure 1). But it also came from other sources. Telecommunications, banking and retail flourished. Construction thrived and FDI surged.

The fastest rates of merchandise export growth were experienced by Southern African countries, especially SACU ones (most notably South Africa) as well as non-COMESA SADC countries. Goods exports from EAC countries grew more strongly towards the end of the period to keep pace with world export growth and those from ECOWAS largely stagnated.

**Figure 1: Some SSA exports of goods have grown much faster than the world average--Index of non-fuel export growth (1998-2009)**



Source: UN Comtrade; data based on SITC Rev 2 mirror data (index 1998=100).

**During the crisis, SSA countries experienced sharp export declines, but have since recovered on the back of increased exports to China**

SSA exports to the OECD markets fell in 2009 as a result of the financial crisis as did their exports to China, except for EAC which grew in that year. Since then SSA exports to OECD markets have only shown slow growth from their 2009 trough, with the exception of ECOWAS countries that have now recovered beyond their pre-crisis level (see Figure 2).

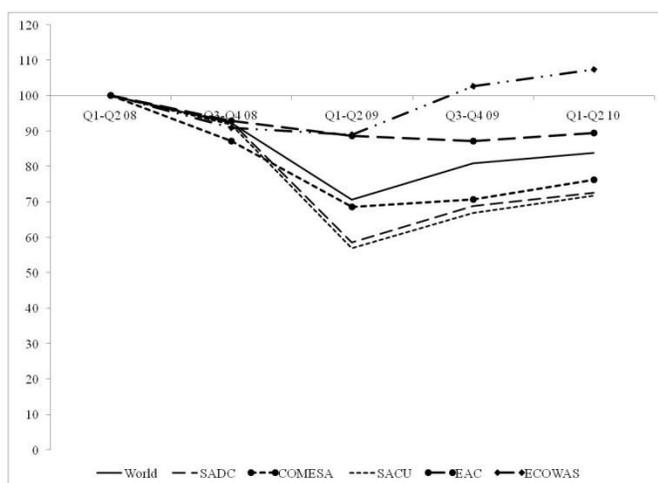
Exports from the rest of the world to OECD markets have recovered faster than SSA countries, except for EAC and ECOWAS. But SSA exports to China have grown much more rapidly, especially for EAC. For example, EAC exports to the OECD countries were over twenty times the value of those to China in the first half of 2008 (US\$1.9 billion versus US\$88 million) but two years later were only six times higher (US\$1.7 billion versus US\$259 million). However, most of this new trade with China is in primary commodities, particularly precious metals, which are low value-added and/or capital intensive. Initial evidence

suggests that exports to South Africa from SACU countries and COMESA and SADC, if Zimbabwe is excluded, have also rebounded strongly.

**Figure 2: Most SSA exports experienced sharp declines as a result of the financial crisis and the recovery is now largely based on increased trade with China**

*Index of export growth (Q1-2 2008 through Q1-2 2010)*

Exports to OECD countries



Source: ITC TradeMap.

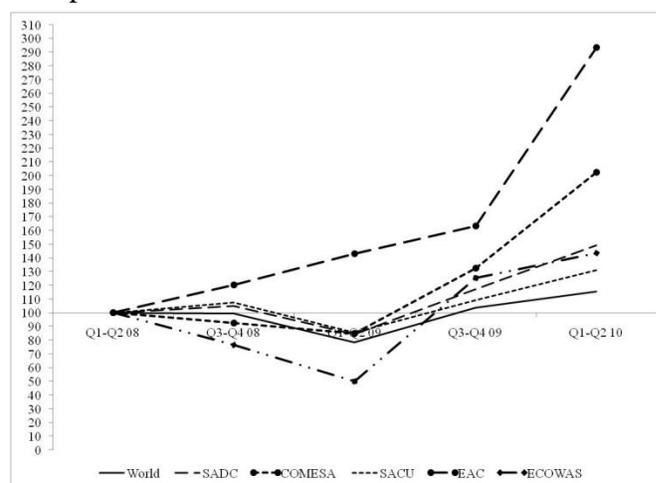
In line with worldwide trends, SSA's services exports have proved more resilient to the crisis than its exports of goods. Interestingly, while world services exports fell by approximately 12% from 2008 to 2009, SSA saw its cross-border services exports decrease by half the world average, at 6.2%. Within SSA, the most resilient group was ECOWAS, where services exports fell by just 0.5%. By contrast, with a decline in cross-border services exports of 11%, COMESA was the least resilient regional group.

**The key issue in the region is how to transform its rich diversity into increased**

**competitiveness and employment for all countries in the post-crisis period**

While exports have grown strongly over the last decade, and the region's trade has started to recover from the global crisis, the impact on unemployment and poverty has been disappointing in many countries. Unemployment remains around 24 percent in South Africa. In Tanzania, extreme income-poverty appears to have remained broadly constant at around 35 percent of the population. In Burkina Faso, income poverty has been stagnant since 1997.

Exports to China



This reflects export growth that has been typically fuelled by a small number of mineral and primary products with limited impacts on the wider economy and formal sectors which remain small in many countries. Hence, key objectives in SSA remain to diversify the export base away from dependence on primary commodities and find policies and processes that will improve the conditions of firms and individuals in the informal sector, increasing opportunities to interact with formal sector

firms and providing a coherent route towards formality.<sup>2</sup>

Regional integration can play a critical role in making progress on these objectives. Deeper integration of regional markets can lower trade and operating costs and relax the constraints faced by many firms in accessing the essential services and skills that are needed to boost productivity and diversify into higher value-added production and trade.

It has been commonly argued that regional integration can only play a limited role in Africa because of the similarity of endowments between its countries. However, this does not reflect the enormous opportunities for cross-border trade in agricultural products from food surplus to food deficit areas; the potential for regional production chains to emerge, as they have done in other regions such as East Asia; and, the scope to develop cross-border trade in services.

Existing figures on the extent of regional trade vastly understate the amount of cross-border trade that is taking place: at many borders between African countries there is limited or no capacity for statistical recording of trade flows and a large amount of trade takes places informally. Services trade between African countries is also poorly measured but examples of the opportunities that are available are becoming increasingly apparent. For example, Uganda has become a successful exporter of education services to countries in East Africa. A number of countries have received investment from South Africa distribution companies.

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<sup>2</sup> Informal sector actors have to be seen as providing an enormous opportunity for growth and poverty reduction rather than simply as a source of revenue loss that must be removed.

### **Implementing this vision is already part of the regional trade policy agenda in SSA...**

There have been considerable developments in RTAs in Eastern and Southern Africa over the past 10 years. The EAC, the smallest regional grouping, has seen the most progress: it has successfully removed tariffs on intra-regional trade, enlarged to five members and established a customs union with a common external tariff (CET). A common market commenced in July 2010 which will ultimately allow all factors of production to move freely within the region. All five members have made commitments to open up and create regional markets in several services sectors and have accepted to remove restrictions on the free movement of workers and on the right of establishment and to pursue mutual recognition of academic and professional qualifications. An ambitious objective has been set of agreeing a protocol on monetary union in 2012 and a common currency in 2015.

SADC has been trading on preferential terms since before 2000 and, based on the implementation of tariff phase down commitments under the SADC Trade Protocol, formally launched a free trade area in August 2008. As a result, 85% of intra-SADC merchandise trade flows are now duty-free with most of the remaining 15% comprising sensitive products scheduled to be liberalized by 2012 (2015 for Mozambique). A SADC Regional Indicative Strategic Development Plan (RISDP), finalized in 2003, recommended that SADC deepen regional integration further by establishing a customs union by 2010, followed by a common market in 2015, monetary union by 2016 and finally a single currency by 2018. The creation of a customs union in 2010 was postponed at the request of South Africa.

COMESA has had a free trade agreement (FTA) since 2000, although not all COMESA members are party to the FTA. Trade between FTA members and non-FTA COMESA countries is conducted on reciprocal terms under the Preferential Trade Agreement. COMESA is also pursuing a customs union. After five years of negotiation, COMESA member states agreed to a CET in May 2007 with four bands (with two bands at zero tariff) for raw materials (0%), capital goods (0%), intermediate goods (10%) and final goods (25%) although, for some products, discussions continue on which category they will be classified under. The customs union was formally launched in June 2009, and all tariff lines carrying a rate above or below these rates have been placed on sensitive product lists. Each member state has its own sensitive product list and timetable to adjust to the CET, which should not exceed five years.

In West Africa, progress on regional integration continues to be slow and there remains a lack of effective and consistent implementation of agreed provisions on regional trade. The ECOWAS Trade Liberalisation Scheme, a preferential trading regime in place for close to 20 years, has had little impact on regional trade. To benefit from free trade within the region, products need to meet relatively stringent rules of origin, and need to be registered through a complex two-stage (national and regional) process. The implementation of the scheme is prone to uncertainty and error. In total, only about 1,100 companies and 3,200 products are registered under the scheme. The West Africa Trade Hub recently published a report showing extensive non-compliance by members with the provisions of the agreement, in terms of inadequate domestic laws and lack of implementation at borders.

Since 2000, UEMOA countries have been applying a CET with four tariff bands (0%, 5%, 10%, 20%) and intra-regional trade seems to be largely duty-free, although unreliable customs data and mis-recorded transit trade flows make it difficult to determine the magnitude of these flows more precisely. By late 2006, ECOWAS member states had largely agreed to adopt the same UEMOA CET with some adaptations as the ECOWAS CET but before final agreement was reached, Nigeria lobbied for the inclusion of a fifth tariff band at 35% (initially proposed at 50%) and ECOWAS member states have agreed to that proposal. The process of modifying the UEMOA CET and agreeing to an ECOWAS CET is therefore far from complete and it is unclear when there will be agreement on the final classification of goods, including products to be included in the high-tariff band; those products to benefit from temporary deviations from the CET (type 'A' exemptions to be removed over a short period of time); and, how to treat products where countries are arguing for adjusting the CET itself (type 'B' exemptions). While UEMOA countries share the same currency, the other 7 countries have been working towards a second monetary zone. Its establishment has been repeatedly delayed, (initially scheduled for 2003) usually for periods of two years, but was recently postponed until 2015 since substantial work remains and most countries consistently miss the convergence criteria. Regional integration in Central Africa seems to have largely stalled and only limited progress has been made.

**... but key challenges remain in integrating markets, particularly regarding NTBs and services.**

While there is still much to be done to put in place effective free trade agreements, especially in Western and Central Africa,

attention is turning to two issues that policy makers are increasingly recognizing as being critical to successful regional and global integration: competitive services markets and removing NTBs. Both of these issues revolve around the nature and quality of regulation, its impact on trade and the need for improved regulatory practices in integrated markets to ensure effective regulation with minimal disruption to trade.

In East and Southern Africa while trade within the various RTAs is now largely duty-free, significant barriers to goods trade remain and intra-regional trade is typically hampered by a large number of NTBs. These NTBs can be broadly grouped into five types and relate to: inefficiencies in transport, border management and logistics; cumbersome fiscal arrangements; restrictive rules of origin; poorly designed technical regulations and standards; and, other non-tariff barriers such as import bans, permits and licensing. NTBs reported by firms in these countries affect one-fifth of regional trade. This ignores the impacts of barriers that prohibit trade altogether, constraints that go unreported as well as costs related to inefficiencies in transport, logistics and customs which affect all goods trade. NTBs undermine the predictability of the trade regime and reduce investment in the region.

There has been progress in establishing reporting mechanisms and monitoring committees for NTBs. Raising awareness and improving transparency are necessary steps but it is becoming increasingly apparent that they are not sufficient due to the lack of progress in removing these barriers. For example, most of the 25 barriers identified by the EAC for immediate removal in 2008 remain in place. Further progress will require members making effective commitments to transparency and non-discrimination in designing and implementing regulations that affect trade as

well as ensuring that regulations are not more trade and investment restrictive than is necessary to fulfill legitimate public policy objectives. Beyond this, countries must agree upon mechanisms that will enforce compliance with commitments to remove trade-restricting barriers. Building on the experiences of other countries will be important but it is clear that regulations must be tailored to local demand and supply conditions in SSA: simply importing harmonized regulations from developed countries will often not be appropriate. This also means that countries will have to address issues relating to the overall quality infrastructure which often remains outdated and creates additional barriers to trade as many regulators do not accept conformity assessment certificates issued by foreign certification bodies, leading to duplicate certification costs to firms.

Policymakers in SSA, especially in Eastern and Southern African countries, are recognizing that weaknesses in their services sectors also impede growth and that without addressing services trade liberalization, deeper regional integration cannot be achieved. All three of the regional groups in Eastern and Southern Africa are committed to the goal of creating an integrated regional market for services. The EAC Common Market Protocol has initiated the integration process in services in Eastern Africa and its five members have scheduled commitments in several services sectors, including adopting annexes on the removal of restrictions on the free movement of workers and on the right of establishment, and an annex on mutual recognition of academic and professional qualifications. Both COMESA and SADC are defining and seeking to implement services liberalization programs. However, relative to the process of regional integration in East Africa, regional integration in Southern Africa is less advanced. For example, SADC

negotiations on services have been ongoing for ten years centering on the framework agreement for the negotiations, i.e., “negotiating how to negotiate”. In ECOWAS, all member states have agreed to the national treatment of individuals and companies of other member states, including full right of establishment. Within UEMOA, specific directives allow the free circulation of providers since 2008 for a number of professional services, including doctors, architects, and lawyers. How effectively these provisions are legally implemented in member states is less clear and cases of discriminatory treatment of service providers within ECOWAS continue to be reported.

In parallel with reform to essential backbone services such as telecommunications, banking and transport, SSA governments are beginning to prioritize reform of business services, tourism, construction and distribution services, including by creating more integrated regional markets. It is also becoming apparent that building infrastructure, an essential element of improved competitiveness and regional and global integration, must be complemented by policies that deliver competitive markets in the provision of services that use the infrastructure. Opening up to trade is a key mechanism for attracting FDI and increasing competition in services sectors. It is necessary, however, to ensure that opening up to trade is coordinated with regulatory reform so that appropriate regulations are in place that address relevant market failures and encourage the competitive provision of services.

There is clear demand from countries and Regional Economic Communities (RECs) in SSA for support in implementing services reforms and addressing NTBs. The World Bank has been providing a range of technical assistance on these issues:

quantifying the economic impact of NTBs in Southern Africa; discussing options for removing NTBs in East Africa; and, providing guidance on the coordination of regulatory reform with services liberalization and facilitating more informed choices as countries contemplate reform a through in-depth case studies.<sup>3</sup> The development of Mutual Recognition Agreements of Professional Qualifications to facilitate the movement of professionals supplying services in SSA features high on the agenda of several regional groupings including COMESA and the EAC.

While the individual RECs have made progress on enhancing integration, policy makers have also recognized that barriers to trade, including tariffs, also persist *between* the various RTAs; a situation that is complicated by the overlapping membership of some countries in more than one regional group. In this context, the Tripartite process was launched in 2008 to enhance integration among the members of the EAC, COMESA and SADC, including the establishment of a pan-regional FTA, which might also include provisions on services trade.

Finally, negotiations continue with the European Union on Economic Partnership Agreements (EPAs). EPAs have been sensitive insofar as they have conflicted with some of the provisions in existing RTAs for example regarding common external tariffs, rules of origin, and the MFN clause (especially in Southern Africa). The EPA negotiations remain an opportunity to support regional integration and trade reform in SSA, but one that is unlikely to be realized unless both sides adopt a more flexible and development oriented approach. A comprehensive agreement with the EU would provide greater credibility to the

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<sup>3</sup> See Africa Trade Policy Notes 1,2, 5, 7, and 9 at <http://go.worldbank.org/M8SXRN80G0>.

reforms that many countries are seeking to implement. A narrow trade agreement will not address the critical issues of appropriate regulations and regulatory capacity that are essential to ensure that greater openness to trade delivers competitively provided goods and services to consumers and firms in SSA. Hence the EPAs must become a flexible tool that is part of a larger process of trade and regulatory reform rather than specific end-points in themselves.

### **Conclusions and Recommendations**

Diversifying exports beyond a narrow range of primary products remains a key challenge in many African countries. Regional integration can play an important role in this by reducing transactions costs and providing a regulatory environment in which services can flow freely and cross-border production networks can begin to flourish.

The key issues facing policy makers in implementing effective RTAs in large parts of SSA has moved beyond removing tariffs to regulatory issues that prevent goods, people and capital freely crossing borders. This is a more complex agenda than reducing tariffs and puts future trade reform efforts more firmly behind-the-border. It is therefore important to put in place efficient regulations that allow for integrated markets in both goods and services while addressing the, sometimes entrenched, political economy constraints that limit reform. In many cases the first step towards removing barriers to integration is to deal with them domestically and to address resistance to reform from bureaucracies and interest groups at home before pursuing reforms with neighbours.<sup>4</sup> Nevertheless, deeper regional integration through regulatory

cooperation with neighboring partners who have similar regulatory preferences can usefully complement unilateral liberalization.

To support the process of trade opening and regulatory reform, the World Bank has proposed the creation of regional knowledge platforms that will foster an inclusive and substantive, evidence-based discussion of the impacts of regulatory policies on trade in both goods and services and the appropriate design of sector-specific regulatory policies that will support countries in SSA to address the challenge of coordinated trade and regulatory reform. The platforms would assist countries in addressing information gaps on the impact of existing policies on trade and economic outcomes; the options for reform and experiences of other countries that have implemented reform programs; and, approaches to identify and address the political economy constraints to reform.

In many SSA countries the private sector and civil society have often been marginalized in the dialogue over regional integration and so the base of support for integration has been very narrow. The process by which integration is defined and implemented is as important as the outcome if there is to be widespread acceptance of reform. This is changing to some extent in Eastern and Southern Africa where business and export councils are coming to play increasingly important roles in driving the discussion about regional trade integration.

Nevertheless, the size of the formal business sector in many SSA countries remains very small and often with limited interest in reform. Considerable activity takes place in the informal sector, especially regarding cross-border trade, in major part as a result of the barriers and constraints to trade and investment that need to be addressed for

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<sup>4</sup> P Lamy (2010) 'Regional Integration in Africa: Ambitions and Vicissitudes', address to the conference organized by ASPEN at Annecy on 28 August 2010.

effective regional integration to be realized. Addressing regulatory and institutional barriers to trade at the border would be an important step in this process by increasing private sector activity and the migration of firms and traders into the formal economy, which in turn will increase the size of the constituency for further reform and integration in the region as a whole.

### ***About the authors***

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